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NOTES

THE CURTAILMENT OF CREDIT

During the month of November an important turning-point in the history of the Federal Reserve System has been reached. On November 4 the Federal Reserve Board announced the adoption of a policy of advancing discount rates, making a statement to that effect which was subsequently published in the *Federal Reserve Bulletin*. Immediately following the issuance of the statement practically all of the Reserve banks advanced their rates $\frac{1}{2}$ of 1 per cent, at the same time abolishing the so-called "differential" or "preferential" rate which has heretofore existed in favor of paper secured by government obligations. In addition to this, steps were taken to eliminate the practice of borrowing at the Federal Reserve bank of New York upon very short-term paper running not more than 15 days. This was brought about by placing the 15-day rate upon an equality with rates for longer periods. It had been found that at the New York bank the great bulk of the borrowing had come to be done at short term because of the more favorable rate for these very brief loans. When longer loans were required renewals would be obtained, but the borrower would secure the advantage of the lower rate for the short-term paper.

These changes, although of relatively limited scope on the surface, had an almost immediate effect. The percentage of reserves to note and deposit liabilities in the Federal Reserve System as a whole reached a low-water mark of a little less than 46 per cent during the week ending November 8, while in the Federal Reserve bank of New York the percentage was below 40. As the legal minimum reserve specified by law is 40 per cent against notes and 35 per cent against deposits, it has been customary to regard 40 per cent for both kinds of liability as in practice the proper minimum of cash reserves. The system therefore was very close to the legal minimum at the time the action of the Federal Reserve Board was taken, and hence the effects of the policy were cumulative.

The announcement was followed by an immediate period of liquidation, coupled with and based upon a call money rate which at times rose as high as 30 per cent, while the shrinkage in stock values was in some cases as much as from 60 to 70 points. The consequence has been a

continuous period of more or less steady liquidation, paralleled by a steady though slow advance in the reserve percentage.

It has been demonstrated fairly conclusively that the evil in the situation lay in the fact that, as the government gradually withdrew from the market as a heavy borrower, the credit thus released was practically transferred to speculative account and so began to furnish the means with which to increase the resources employed in "marking up" stocks and bonds upon the exchanges. It is the view of many that this process of marking up cannot be regarded as confined to the securities markets. The enormously high levels of prices for cotton, grain, and many sorts of commodities are ascribed to the excessive use of bank credit in "carrying" them. This makes the expansion of the loans of banks to which exception has been taken by the Federal Reserve Board a national rather than a local problem and points to the necessity of dealing with it in its various manifestations. This kind and scope of action the policy of the Federal Reserve Board obviously contemplates.

FOREIGN FINANCING

One unexpected effect of the curtailment of credit due to excessive speculative activity which has resulted in shortening the available resources of banks throughout the country has been the discouraging of efforts to finance foreign trade. It has become evident for a good while past that our relations with foreign countries were assuming an extremely critical aspect from the economic point of view. On November 20 the pound sterling was quoted at less than \$4.00 in New York, while the quotations of francs, lire, marks, and other European currencies have shown far greater depression.

Although this shrinkage of foreign-exchange values had been in progress for a great while before the adoption of a policy designed to curtail bank loans, the natural reflex effect of the curtailment policy has been that of making evident to foreigners that they can expect but little result from efforts to obtain bank support for their various plans, however meritorious they may be. During the past month efforts at foreign financing have met with the most discouraging reception. The loans floated by the Swiss and Scandinavian governments have been barely successful, while a considerable part of the British loan of \$250,000,000 has been taken and carried by the underwriters. A number of foreign financing projects which had been launched before the curtailment policy was inaugurated are having great trouble in attaining any

degree of success, while a number of others which had been in process of development when the collapse of security prices occurred have been for the time being abandoned. Foreign observers who have come to the United States for the purpose of studying the situation are frankly discouraged because of the fact that European countries have apparently reached the limit of their credit in the United States.

On November 17 the Conference Committee on the Edge bill which provides for the establishment of financing corporations authorized to undertake the placing of foreign securities reached an agreement upon what will undoubtedly be the text of the final act save for purely verbal changes. The bill differs in no important respect from the original project, but its terms are such as to require the existence of a considerable amount of public support if the securities to be offered by these new corporations are actually to appeal to the rank and file of investors. As a matter of fact it is the general opinion at the present time that the bill has come rather too late to be of immediate service in capturing the investment funds of the country. Accordingly there is some reaction against government support of foreign credit in order to insure the placing of loans in this country. The outcome undoubtedly is to leave the prospect of financing our foreign trade in an unfortunate position because of the consumption of so much of our spare supply of credit in the ways already indicated.

Following the recommendation of the Committee on Credit and Finance of the recent International Trade Conference at Atlantic City, the Chamber of Commerce of the United States announced on November 23 the formation of a National Committee on European Finance, to study plans for meeting the exchange situation and supplying the necessary long-time credit for Europe's purchases. The chairman of the new body is Harry A. Wheeler, Vice-President of the Union Trust Company, of Chicago.

RAILWAY LEGISLATION

The House of Representatives on November 17 passed the Esch bill providing for the re-transfer of the railroads back to their owners and for the establishment of the financial relationships between the roads and the government upon a more stable basis. Meanwhile comparatively little progress has been made with the Cummins bill in the Senate. The two bills aim at somewhat similar results, although they differ materially between themselves in matters of technique and detail.

In general, what is sought is to regulate the return to be obtained upon railroad capital and to insure the maintenance of a schedule of rates adequate to that end. In the Cummins bill provision is made for a "transportation board," whose function it should be to bring about a reorganization of the roads into a small number of "systems." This plan is not recognized by the Esch bill, which is in a great many respects simpler than its rival. Both bills practically re-establish the power of the Interstate Commerce Commission upon the pre-war basis, although with what amounts to instruction to it to insure a reasonable return to railroad capital legitimately invested. Both obviously depend upon the results of the physical valuation of the roads which has been in progress for some years past as affording a guide to the regulation of railroad rates by fixing the basis upon which the stated rate of return is to be computed.

It is now believed likely that provision will merely be made for the return of the roads to their owners at the end of the year with perhaps a continuation of government support of their revenues for some months to come. This would give Congress a longer period for the discussion of the railroad question in its broader aspects and would permit the more careful working out of the provisions relating to the rate-making power of the Interstate Commerce Commission, as well as those bearing upon the future international status of the roads. Both bills now pending before the Houses of Congress have been subjected to severe criticism, and neither one of them is believed likely to solve the various questions which have arisen during the period of government operation. One factor which has received particular attention since these bills were presented is the money-market situation of the roads. It is recognized today that with rising rates for capital adequate provision must be made for inducing capital to go into railroad investments, unless a continuous shortage of such capital is expected. Good railroad opinion seems to hold that the proposed rate of $5\frac{1}{2}$ to 6 per cent contemplated by the bills now in Congress as a standard of normal return would be inadequate to induce capital to go into the business of transportation.

THE ECONOMIC SIDE OF THE PEACE TREATY

The action of the Senate in rejecting on November 18 the proposed treaty of peace with Germany has some important economic aspects which have been largely neglected in the current discussion of the document and of the policy to be accepted under it. Now that ratification has been decided against, or at least postponed for some time, and now that the other countries which were parties to the negotiations have apparently determined to put the document into operation, the effect of what has been done or left undone by and in behalf of the United States becomes an acute question.

Apart from the effect likely to be produced upon the volume and conditions of our trade by the application of the terms of the treaty through the "Reparation Commission," to be constituted under it, there are several significant elements in the situation caused by the Senate's action. Among these may be enumerated the following:

1. The authority conveyed to us under the Treaty to call into renewed existence any of the commercial treaties or arrangements which existed between ourselves and Germany prior to the war.

2. The validation of our action in seizing German merchant ships interned in our harbors, and in seizing, through the Alien Property Custodian, the property of German citizens in the United States.

3. The recognition of our right to permit American citizens to use German-owned patents, trade-marks, and other like properties during the continuance of the war.

4. The undertaking by Germany not to subject our goods or ships to any unfavorable or discriminating conditions when entering German ports. All these as well as other rights established under the treaty are either abandoned or held in abeyance. As a result of the situation the disposition of our bankers to finance and of our producers to trade with Germany has received a severe blow. Meanwhile the decision of the other countries to proceed as of December 1 with the application of the terms of the treaty necessarily gives them an advantage, for the time being at least, in the re-establishment of trade relations with Germany. We may be able to secure to ourselves by later negotiation the same advantages which are specified in the treaty, but success in so doing will, at all events, require negotiations of considerable length.

Meanwhile the conditions under which the indemnity shall be paid, the exchange situation as affecting Germany be settled, the investment of capital and the financing of trade relations with that country be carried

on, and the adjustment of outstanding bills and accounts, will proceed toward determination and application at the hands of a Commission in which the United States will not be represented. This opens an important administrative and diplomatic question respecting the proper mode of procedure to be adopted in protecting our national interests pending the establishment of some permanent *modus vivendi* with Germany and with our associates in the war against that country.